

**ST 07-21**

**Tax Type: Sales Tax**

**Issue: Exemption From Tax (Charitable or Other Exempt Types)**

**STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
CHICAGO, ILLINOIS**

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**THE DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS**

**No: 00 ST 0000**

**Sales Tax Exemption**

**v.**

**ABC SERVICES,**

**TAXPAYER**

**Kenneth J. Galvin  
Administrative Law Judge**

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**RECOMMENDATION FOR DISPOSITION**

**APPEARANCES:** Mr. Michael J. Hayes, Sr. and Ms. Mary M. Donners, Bell, Boyd & Lloyd, LLP, on behalf of ABC Services; Mr. John Alshuler, Special Assistant Attorney General, on behalf of The Department of Revenue of the State of Illinois.

**SYNOPSIS:** On June 30, 2006, the Illinois Department of Revenue (hereinafter the “Department”) revoked ABC Services’ (hereinafter “ABC”) sales tax exemption number “on the basis that [ABC] is no longer organized and operating for charitable purposes under 35 ILCS 120/2-5 and Title 86, Part 130, Section 130.120 of the administrative code.” Dept. Ex. No. 1. On July 13, 2006, ABC protested the Department’s revocation and requested a hearing, which was held on May 17, 2007 with testimony from XXXXX, Director of Health Care Operations for XXXXX Services Group which manages ABC, XXXX, General Manager for ABC and employee of XXXXX Services Group, XXXXX,

Vice-President of Finance at XXXXX Medical Center and Vice-Chairman of the Board of Directors of ABC and XXXXX, Chief Financial Officer for ABC.

The sole issue to be determined at the hearing was whether ABC qualified for an exemption identification number as “a corporation, society, association, foundation or institution organized and operated exclusively for charitable ... purposes.” 35 ILCS 120/2-5. Following a careful review of the evidence and testimony presented at the hearing, and ABC’ “Memorandum of Law Submitted after Hearing” (ABC Memo.), the Department’s “Response Brief” (Dept. Resp.), and ABC’ “Reply Brief Submitted after Hearing” (ABC Reply), I recommend that the Department’s revocation of ABC’ sales tax exemption number be affirmed.

**FINDINGS OF FACT:**

1. The Department’s *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of the Department’s revocation of exemption dated June 30, 2006. The revocation states that “[I]n order for your organization to qualify for exemption, it would have to be organized and operating exclusively for charitable purposes.” “[I]t has been brought to the Department’s attention that [ABC] has been conducting business in a manner inconsistent with a charitable institution. These practices include conducting business with entities outside the scope of its organizational by-laws and making retail sales.” Tr. pp. 26-29, 165-166; Dept. Ex. No. 1.
2. ABC was incorporated on August 26, 1969 under the Illinois “General Not For Profit Corporation Act.” Tr. pp. 131-132; Taxpayer’s Ex. No. 3.
3. ABC is not recognized as a charitable organization under section 501(c)(3) of the Internal Revenue Code. Tr. pp. 78, 138, 151.

4. ABC' Bylaws, Article I, state that its purpose, *inter alia*, is "to operate as an association of hospitals and other institutions organized exclusively for charitable, educational or scientific purposes: (a) to operate one laundry facility or more to furnish its members and non-member hospitals and institutions laundry services, linens, linen supplies, uniforms, and related products and services; (b) to obtain and/or provide such supplies, products and services; (c) to furnish disposable linens and uniforms; and (d) to do any and all things permitted by law in order to provide the foregoing on a cooperative basis for its member and non-member hospitals and institutions which they might otherwise provide for themselves." Tr. pp. 122-123; Taxpayer's Ex. No. 2.
5. ABC' Bylaws are not dated. There is no indication in the Bylaws when/if they were adopted by ABC. No Board of Directors Resolution adopting the Bylaws was admitted into evidence. Taxpayer's Ex. No. 2.
6. ABC' Bylaws, Article III, state that a "member" of ABC (a) "shall be a hospital or other institution organized exclusively for charitable, educational or scientific purposes and shall be exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code, and (b) shall have executed an agreement with [ABC] in which it is provided that such hospital or other institution agrees to obtain such laundry services from [ABC] and for such term as shall be specified in the agreement." Tr. pp. 122-123, 126; Taxpayer's Ex. No. 2.
7. ABC' Bylaws, Article III, list 14 "Original Members." According to the Bylaws, original members remain members as long as they meet the qualifications for membership and "are not in breach of the agreement executed there under," and as long as they have not withdrawn from the corporation.

Additional members may be such qualified hospitals and other institutions as from time-to-time shall be elected by a three-fourths affirmative vote of the Board of Directors of ABC. Tr. pp. 192-200; Taxpayer's Ex. No. 2.

8. ABC' Bylaws, Article XVII, state that non-members of ABC shall be such hospitals or other institutions organized exclusively for charitable, educational or scientific purposes, and which are exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. A non-health care institution shall not be eligible to become a non-member unless (1) such institution satisfactorily demonstrates to the Board of Directors that such institution is exempt from federal and state income, and state sales, use, retailers' occupation, service occupation, service use and real estate taxes, or (2) "the Board of Directors receives an opinion of counsel, selected by it, to the effect that such institution would be eligible for exemption from all such taxes." Taxpayer's Ex. No. 2.
9. ABC' Bylaws, Article XVI, entitled "Patronage Dividends," state that if ABC realizes taxable income in any fiscal year, such taxable income shall be distributed to the members and non-members of the corporation within 8½ months after the close of the fiscal year on the basis of the quantity of business done between each member or non-member and the corporation during the fiscal year. Taxpayer's Ex. No. 2.
10. A letter dated August 16, 1972, from the Department's "Director of Revenue," by "Willard Ice, Manager" to attorneys for ABC states that "[ABC] is a not-for-profit corporation whose sole purpose is to provide laundry service and to procure and sell supplies to the corporation's members, all of whom are income

tax exempt, nonprofit hospitals to which this Department has issued letter rulings exempting them as buyers for sales tax purposes on the ground of being an exclusively charitable institution.” “[W]e believe that [ABC], in making laundry service and supplies more economical to, and efficient for, its member charitable institutions confers enough benefit on such charitable institutions to qualify as an exclusively charitable organization itself.” “Since the supplies which [ABC] will sell will be sold only to its member hospitals which we have ruled to be exempt buyers for sales tax purposes, such sales by [ABC] will not be subject to retailers’ occupation tax.” ABC’ exemption was renewed on May 27, 2005. Tr. pp. 31-38; Dept. Ex. No. 2.

11. ABC provides pillowcases, sheets, blankets, patient gowns, various bed linens, scrub suits and surgical gowns, surgical towels, surgical drapes that section off the surgery site, special coverings for the tables in the surgery suite and housekeeping linens including rags to the facilities that it services. ABC also provides linen management to the facilities, where ABC employees, including an on-site manager and distribution staff, are contracted out to the facility. These employees receive the linen from ABC, distribute the linen to units and departments in the facility, pick up soiled linen and send it back to ABC. Tr. pp. 60-62.
12. Various organizations, including the Illinois Department of Public Health, Chicago Department of Health (for facilities located in the City), The Joint Commission on Accreditation for Hospital Organizations, the Food and Drug Administration and the Centers for Disease Control set standards for the linen

cleaning process, temperatures used for washing, and chemistry to ensure that linen is hygienically clean. Tr. pp. 67-68, 97-98.

13. Customers that use ABC sign a “Customer and ABC Services Laundry-Linen Service: 3 Year Agreement.” Paragraph 21 of this Agreement, entitled “Tax Exempt Status,” states that “Customer shall, during the period covered by this Agreement, maintain its status as a hospital or other organization exempt from federal income tax under 501C(3) of the Internal Revenue Code of 1986 and its successor sections, and exempt from federal and state income and sales, use, retailers’ occupation, service use and real estate taxes. Upon the loss of any such exemption, customer shall immediately notify ABC.” Tr. pp. 71-73; Taxpayer’s Ex. No. 1.

14. An ABC advertisement entitled “The right RX for your COMFORT & PROTECTION” advertises textile surgical gowns, barrier gowns and drapes. Another ABC advertisement entitled “Quality, Convenience and Savings Go a Long Way” states that “[ABC], a company owned and operated by a group of Chicago area hospitals and nursing homes, has been the innovative leader in linen services to the healthcare community for the past thirty years. ABC offers high quality, hygienically clean linen items with a 100% satisfaction guarantee.” ABC drivers, making deliveries, drop these pamphlets off at existing service locations or at locations near to existing service locations that are not using ABC’ services. Neither of the brochures mentions that ABC is owned by hospitals and nursing homes that are non-profit and 501(c)(3) organizations or that ABC only processes laundry for and sells supplies to section 501(c)(3) companies, as is required by its Bylaws, or that ABC will provide free service

to an organization that cannot afford to pay. Tr. pp. 181-182; Dept. Ex. Nos. 6 and 7.

15. The “Audit Narrative” for ABC dated November 28, 2006, states that “[ABC] also sells recyclable bags which are used to transport their customer’s laundry. These bags are sold to their customer[s], ABC picks up the soiled linen in the bags and transports them to their headquarters in Wheeling. The bags are then disposed of after the linens are emptied.” “The only tangible personal property the taxpayer sells are the recyclable bags.” The Department’s auditor assessed retailers’ occupation tax on approximately \$19,000 in recyclable bags sold to 10 taxable customers for the audit period. Tr. pp. 38-51, 104-105, 113-114, 159-162, 186-191; Dept. Ex. Nos. 3 and 4.
16. On October 2, 2006, the Department issued an EDA-123, “Notice of Proposed Assessment,” to ABC for sales tax due on the recyclable bags in the amount of \$1,662 plus penalty and interest. Tr. pp. 162-164; Taxpayer’s Ex. No. 4.
17. ABC’ “Statement of Income” for year-end August 31, 2006 and 2005 shows “Total Revenues” of \$34,769 M and \$37,672 M, respectively. Note 1 to the financial statements states that revenues from members were approximately \$19,173 M and \$18,836 M for year-end August 31, 2006 and 2005 respectively. “Net Income (Loss)” from operations was \$57,315 for 2006 and (\$2,145,955) for 2005. Tr. pp. 133-135; Dept. Ex. No. 5.

### **CONCLUSIONS OF LAW:**

An examination of the record establishes that ABC Services has not demonstrated, by the presentation of testimony or through exhibits or argument, evidence sufficient to warrant an exemption from sales tax. Accordingly, under the reasoning

given below, the determination by the Department revoking ABC' sales tax exemption number should be affirmed. In support thereof, I make the following conclusions.

ABC was incorporated on August 26, 1969 under the Illinois "General Not For Profit Corporation Act." Tr. pp. 131-132; Taxpayer's Ex. No. 3. ABC is not recognized as a charitable organization under section 501(c)(3) of the Internal Revenue Code. Tr. pp. 78, 138, 151. According to ABC' audited financial statements, "the Company operates as a nonexempt cooperative for federal and state income tax purposes." Dept. Ex. No. 5. There was testimony that ABC is currently owned by XXXXX Health Systems, XXXXX Covenant Hospital, XXXXX Community Hospital, XXXX Health Partners, XXXXXX Hospital, XXXX Hospital, XXXX Medical System, XXXX Hospital, XXXX Health Care, XXXX Group and XXXX Home for the Aged. Tr. pp. 56-57, 88, 193. Both XXXXX and XXXXX testified that ABC' owners are not-for-profit corporations and section 501(c)(3) organizations. Tr. pp. 57-58, 125-126. No documentary evidence was admitted to support this.

ABC provides pillowcases, sheets, blankets, patient gowns, various bed linens, scrub suits and surgical gowns, surgical towels, surgical drapes that section off the surgery site, special coverings for the tables in the surgery suite and housekeeping linens, including rags, to the facilities that it services. ABC also provides linen management services to the facilities, wherein ABC employees, including an on-site manager and distribution staff, are contracted out to the facility. These employees receive the linen from ABC, distribute the linen to units and departments in the facility, pick up soiled linen and send it back to ABC. Tr. pp. 60-62. Various organizations, including the Illinois Department of Public Health, Chicago Department of Health (for facilities located in the City), The Joint Commission on Accreditation for Hospital Organizations, the Food and



Drug Administration and the Centers for Disease Control set standards for the linen cleaning process, temperatures used for washing, and chemistry to ensure that linen is hygienically clean. Tr. pp. 67-68, 97-98.

The first step in determining whether an organization is charitable is to consider the provisions of its charter. Rotary International v. Paschen, 14 Ill. 2d 480 (1958). ABC' Bylaws state that its purpose, *inter alia*, is "to operate as an association of hospitals and other institutions organized exclusively for charitable, educational or scientific purposes: (a) to operate one laundry facility or more to furnish its members and non-member hospitals and institutions laundry services, linens, linen supplies, uniforms, and related products and services; (b) to obtain and/or provide such supplies, products and services; (c) to furnish disposable linens and uniforms; and (d) to do any and all things permitted by law in order to provide the foregoing on a cooperative basis for its member and non-member hospitals and institutions which they might otherwise provide for themselves." Tr. pp. 122-123; Taxpayer's Ex. No. 2.

A letter dated August 16, 1972, from the Department's "Director of Revenue," by "Willard Ice, Manager" to attorneys for ABC, which exempted ABC from sales tax, states that ABC is a not for profit corporation "whose sole purpose is to provide laundry service and to procure and sell supplies to the corporation's members, all of whom are income tax exempt, non-profit hospitals to which this Department has issued letter rulings exempting them as buyers for sales tax purposes on the ground of being an exclusively charitable institution." "[W]e believe that [ABC], in making laundry service and supplies more economical to, and efficient for, its member charitable institutions confers enough benefit on such charitable institutions to qualify as an exclusively charitable organization itself." "Since the supplies which [ABC] will sell will be sold

only to its member hospitals which we have ruled to be exempt buyers for sales tax purposes, such sales by [ABC] will not be subject to retailers' occupation tax." Tr. pp. 31-38; Dept. Ex. No. 2.

It must be noted at the outset that the Department's 1972 letter exempting ABC from sales tax stated that ABC' "sole purpose" was to provide laundry service and sell supplies to its members, "all of whom are income tax exempt, non-profit hospitals." Dept. Ex. No. 2. This "sole purpose" appears to be consistent with ABC' "Articles of Incorporation," filed in 1969, under the Illinois "General Not For Profit Corporation Act." These Articles state that ABC' purpose, *inter alia*, is "to operate one or more laundry facilities to furnish its member hospitals and health care institutions laundry services, linens, linen supplies, uniforms and related products and services." Taxpayer's Ex. No. 3.

ABC argues in its Memorandum that the organization "has not materially changed its operations since it was first issued its sales tax exemption in 1972..." (ABC Memo. p. 3). However, ABC' "sole purpose" in the 1972 letter is not reflected in ABC' Bylaws, which permit ABC to "furnish its members and non-member hospitals and institutions laundry services, linens, linen supplies, uniforms, and related products and services." Taxpayer Ex. No. 2. The provision in the Bylaws allowing ABC to furnish laundry service and products to non-members is inconsistent with the Department's exemption letter of 1972 and with ABC' Articles of Incorporation. The Bylaws are undated and there is no indication in the Bylaws as to when/if they were adopted by ABC. No Board of Directors resolution adopting the Bylaws was admitted into evidence. Given these facts, it is reasonable to conclude that the Bylaws were not provided to the Department in 1972 when the Department first exempted ABC. If this is the case, ABC cannot rely on

an exemption granted without all of the pertinent facts having been provided to the Department.

ABC' sales tax exemption was last renewed on May 27, 2005. Dept. Ex. No. 2. This renewal says "[W]e have received your recent letter; and based on the information you furnished, we believe [ABC] is organized and operated exclusively for charitable purposes." Dept. Ex. No. 2. There was no testimony or documentary evidence offered at the evidentiary hearing showing that the Bylaws were included with the information furnished by ABC for its exemption renewal. The record contains no evidence as to whether the Department has ever seen ABC' Bylaws before the audit in 2006.

Counsel for ABC asked Mr. XXXX the following question:

Q. So under the bylaws, it was provided, from the day they were passed, that members and nonmembers would be able to receive the services from ABC; is that correct?

A. That's correct.  
Tr. p. 199.

The problem with this question and answer is that no evidence was presented at the hearing as to "the day" the Bylaws were passed, if in fact, they were passed. ABC' arguments throughout the hearing that they are entitled to a sales tax exemption because they are in compliance with their Bylaws, in processing laundry and selling supplies to non-members, has no merit because they presented no testimony, and no documentary evidence, as to when/if the Bylaws were adopted and whether the Department was ever furnished with a copy of the Bylaws. Because the Bylaws are inconsistent with the Department's 1972 letter exempting ABC and are inconsistent with ABC' Articles of Incorporation and because ABC relies on the Bylaws to justify the operations that it feels entitles it to a sales tax exemption, it was incumbent on ABC to provide evidence as to when the Bylaws were adopted and that the Department was provided with a copy of the

Bylaws during previous renewals of the sales tax exemption. ABC' failure to provide this evidence, and other evidence pivotal to this case, as discussed below, provide support for affirming the Department's revocation of ABC' sales tax exemption.

The Department revoked ABC' tax exemption number in a letter dated June 30, 2006, "on the basis that your organization is no longer organized and operating for charitable purposes under 35 ILCS 120/2-5 and Title 86, Part 30, Section 130.120 of the administrative code." The provisions cited exempt from sales tax personal property sold to an institution organized exclusively for charitable purposes. The revocation letter also states that "[I]n order for your organization to qualify for exemption, it would have to be organized and operating exclusively for charitable purposes." "[I]t has been brought to the Department's attention that [ABC] has been conducting business in a manner inconsistent with a charitable institution. These practices include conducting business with entities outside the scope of its organizational by-laws and making retail sales." Tr. pp. 26-29, 165-166; Dept. Ex. No. 1.

ABC protested the Department's revocation and requested a hearing as to whether the organization qualifies for an exemption identification number as an institution organized and operated exclusively for charitable purposes. In Methodist Old People's Home v. Korzen, 39 Ill. 2d 149 (1968), the Illinois Supreme Court outlined several factors to be considered in assessing whether an organization is an institution of public charity: (1) the benefits derived are for an indefinite number of persons [for their general welfare or in some way reducing the burdens on government]; (2) the organization has no capital, capital stock or shareholders; (3) funds are derived mainly from private and public charity, and the funds are held in trust for the objects and purposes expressed in the charter; (4) the charity is dispensed to all who need and apply

for it, and the organization does not provide gain or profit in a private sense to any person connected with it; (5) the organization does not appear to place obstacles of any character in the way of those who need and would avail themselves of the charitable benefits it dispenses.

In determining whether ABC qualifies for an exemption identification number as an exclusively charitable organization, it is necessary to look at whether ABC presently has the characteristics of an exclusively charitable organization as outlined in Korzen; at whether ABC' activities have materially changed since the original issuance of the exemption number in 1972; and whether it "conducts business in a manner inconsistent with a charitable institution," including conducting business with entities outside the scope of its organizational by-laws and making retail sales," as determined by the Department in its revocation letter. Dept. Ex. Nos. 1 and 2.

**THE ORGANIZATION HAS NO CAPITAL, CAPITAL STOCK OR SHAREHOLDERS:** There was testimony at the evidentiary hearing that ABC does not have capital, capital stock or shareholders. Tr. p. 90. ABC' Bylaws contain no provisions related to shareholders or the issuance of capital stock. Taxpayer's Ex. No. 2. ABC was incorporated on August 26, 1969 under the Illinois "General Not For Profit Corporation Act." Tr. pp. 131-132; Taxpayer's Ex. No. 3.

**FUNDS DERIVED FROM PUBLIC AND PRIVATE CHARITY AND FUNDS HELD IN TRUST FOR THE OBJECTS AND PURPOSES EXPRESSED IN THE CHARTER:** ABC had "total revenues" of \$34,769 M and \$37,672 M for year-end August 31, 2006 and 2005, respectively. In 2006 and 2005, respectively, 76% and 70% of ABC' "total revenues" was derived from "laundry processing charges." The remaining components of "total revenues" for both years are composed of various other

“processing charges” and “rag and recyclable bag sales.” Dept. Ex. No. 5. ABC’ revenue is derived from laundry and other processing charges and sales of supplies, similar to any for-profit laundry processing business. Some of ABC’ revenue may have been provided by charitable institutions, but they are paying for a service, not making a donation. There is no indication in the financial statements and there was no testimony at the evidentiary hearing that any of ABC’ revenue was donated from public and private charity, for charitable purposes, one of the guidelines from Korzen for determining whether an organization is an institution of public charity.

Furthermore, I am unable to conclude that the revenue that ABC receives is held in trust for any charitable purpose. At the evidentiary hearing, there was only anecdotal testimony regarding charitable activity by ABC. XXXX testified that some of “our hospitals” are affiliated with homeless shelters and ABC will launder the shelter’s linen free of charge. “Numerous times” during the year, ABC gets requests from hospitals doing mission work in third world countries. “And so we will donate linens and surgical supplies for them to use for that mission work that they do.” Tr. pp. 70-71. XXXXX testified that ABC provides free-of-charge laundry service for several churches and shelters in and around the Chicago area. “Linen that they need and use for their ongoing mission is brought to ABC through one of the – or some of the owners, and it is laundered, dried, folded and packaged and returned to them at no charge.” Tr. p. 103.

No documentary evidence was offered by ABC with regard to any of the activity described above. There was no testimony as to the dollar value of any of these activities. ABC’ financial statements, including notes, do not mention any charitable activity by ABC. Based on the testimony and evidence, I am unable to conclude that ABC’ derives

its funding from private and public charity or that the funds are held in trust for charitable purposes, one of the characteristics of a charitable organization mentioned in Korzen.

**Non-member Customers:** “Note 2” to ABC’ financial statements states that revenues from members were approximately \$19,173 M (of \$34,769 M total revenue) and \$18,836 M (of \$37,672 M total revenue) for the years 2006 and 2005, respectively. Dept. Ex. No. 5. In 2006 and 2005, revenue from non-members constituted 45% and 50%, respectively, of ABC’ “total revenues.” XXXXX testified at the evidentiary hearing that, in addition to the [undocumented] “charitable” activities discussed above, ABC provides charitable [laundry] services for its owners. Tr. p. 102. If ABC’ laundry services are, in fact, charitable, then 45% to 50% of this “charity” was being provided to unidentified non-member customers, some of whom are for-profit businesses, as discussed below.

Moreover, it is apparent from the information contained in “Note 2” to the financial statements that ABC’ activities have materially changed since the issuance of its sales tax exemption number in 1972. The 1972 letter from the Department exempting ABC from sales tax states that ABC’ “sole purpose” is to provide laundry service and to procure and sell supplies to the corporation’s members. This was the basis for the Department’s exemption of ABC from sales tax as an “exclusively charitable organization.” Dept. Ex. No. 2. With 45% and 50% of ABC’ revenue derived from providing laundry services and selling supplies to non-members in 2006 and 2005, respectively, ABC’ “sole purpose” has obviously, significantly and materially changed since 1972.

The 1972 letter from the Department concludes that ABC, in making laundry service and supplies more economical to, and efficient for, its member charitable

institutions, confers enough benefit on such charitable organizations to qualify as a charitable organization itself. However, quite clearly, this same conclusion cannot be reached today because in 2006 and 2005, ABC was making laundry services and supplies more “economical” and “efficient” on an equal basis for both its members and non-members. At the very least, the conclusion reached by the Department in 1972 that the benefits conferred by ABC on its member organizations qualified ABC, itself, as a charitable organization is no longer warranted because of the significant amount of revenue that ABC derives from non-members.

In its Memorandum of Law, ABC frequently cites Association of American Medical Colleges v. Lorenz, 17 Ill. 2d 125 (1969), as support for its position that it is entitled to a sales tax exemption. In American Medical Colleges, a not-for-profit corporation, whose members included American medical colleges, challenged the Department’s denial of an educational property tax exemption. The Department argued that the property was not used for school purposes because it was not devoted to class work and that the functions that the applicant performed for its member institutions were primarily administrative and statistical having only an incidental relationship to teaching.

The Court rejected the Department’s arguments finding that the functions to which the plaintiff’s property is devoted “are identical to those which would afford exemption if conducted separately by its member institutions.” “Where the functions themselves qualify for exemption, it does not matter that they are performed by a separate organization rather than by the respective member institutions.” *Id.* at 129. ABC argues in its Memorandum that, similar to American Medical Colleges, it “provides its member and non-member charities with essential services that if conducted separately by any of the charities themselves, would undoubtedly qualify as exempt.” “ABC benefits its



customers by taking advantage of economies of scale to reduce duplication of effort, by providing cost-savings and increased efficiency, and by providing other important benefits.” (ABC Memo. pp. 14-15)

The problem with ABC’ analogy and the reason that American Medical Colleges does not provide a basis for exemption of ABC is that American Medical Colleges provided services to its members only. The Court found that the “functions” which American Medical Colleges performed would be exempt if conducted separately by its “member institutions” or performed by the “respective member institutions.” In 1972, the Department made a similar finding in exempting ABC because its “sole purpose” was to provide laundry service and sell supplies to its members, “all of whom are income-tax exempt, nonprofit hospitals to which this Department has issued letter rulings exempting them as buyers for sales tax purposes on the ground of being an exclusively charitable institution.” Dept. Ex. No. 2.

In 2006 and 2005, 45% and 50%, respectively, of ABC’ revenues were derived from non-members. The record in this case does not allow me to conclude that the functions that ABC performs for non-members would be exempt if conducted separately or performed by non-members. Frankly, I have no idea who ABC’ non-member customers are. No documentary evidence was offered on who the non-member customers are, whether the non-member customers are hospitals or non-health care institutions, the number of non-member customers, whether the non-member customers were issued letter rulings exempting them from taxes by the State of Illinois, and what internal controls are in place at ABC to ensure that non-member customers have received and maintain recognition as institutions exempt from tax in accordance with Illinois statutes. Statements of the agents of an institution and the wording of its governing legal

documents showing an intention to be operated for charitable purposes do not relieve the institution of the burden of proving that it is factually and actually so operated. Morton Temple Ass'n v. Dept. of Revenue, 158 Ill. App. 3d 794 (3d Dist. 1987). Without documentary evidence showing that ABC' non-member customers are charitable institutions, I am unable to conclude that the functions that ABC performs for these non-members would be exempt if performed separately by the non-members.

Furthermore, there is a provision in ABC' Bylaws for non-member "non-health care institutions" which requires that these institutions (1) "satisfactorily" demonstrate to the Board of Directors that they are exempt from federal and state income, and state sales, use, retailers' occupation, service occupation, service use and real estate taxes; or (2) "the Board of Directors receives an opinion of counsel selected by it to the effect that such institution would be eligible for exemption from all such taxes." There was no testimony or documentary evidence as to what is meant by "satisfactorily" demonstrate. I question whether it would be "satisfactory" and whether ABC would begin "charitably" processing laundry and making retail sales to a "non-health care institution" that telephoned ABC advising that they were exempt from taxes. There was no testimony that ABC requires documentary proof of exemption status from potential non-member customers.

As discussed previously, the record in this case is completely devoid of any information on non-member customers of ABC. But more importantly, as discussed below, ABC does not adhere to the provision in its Bylaws that non-members must be exempt under section 501(c)(3) and has "discovered" that some customers do not have this exemption. Tr. pp. 64-65. Unlike American Medical Colleges, where the applicant performed exempt functions for its members, and unlike ABC in 1972 whose "sole

purpose” was to provide laundry processing and sell supplies to its members only, approximately half of ABC’ “functions” are performed for unknown non-members. In fact, an indeterminate number of these non-members are for-profit businesses, not exempt under section 501(c)(3), as discussed below.

**For-Profit Non-Members:** XXXX testified that ABC’ customer base is composed of 45 hospitals, 12 long-term care facilities, 12 surgery centers and 400 off-site locations. “Off-site locations” are out-patient facilities and surgery centers that are located apart from the actual hospital building but may be on the hospital campus. Tr. p. 82. Some of ABC’ members have multiple institutions. For example, XXXX Health Care, one of ABC’ eleven current members, has approximately 8 different hospitals. Tr. p. 59.

Testimony at the evidentiary hearing was contradictory as to how many of ABC’ non-member customers are not-for-profit versus for-profit entities. XXXX testified that “somewhere in excess of 90% are not-for-profit health care institutions.” She stated that ABC operates a “clinic route,” where a not-for-profit hospital that is a customer of ABC has offsite outpatient facilities, urgent care centers and surgery centers. XXXX Health Care “has a number of different organizations like XXXXMedical Group, XXXX Health Centers, surgery centers, that they own or have partial [ownership]...” “We have discovered that some of those, even though they’re joint ventures with our customers, may not have the 501(c)(3) designation.” XXXX estimated that 10% of ABC’ business is the “clinic route” and 40% of “that group may fall under that [for-profit] designation.” Tr. pp. 63-65.

XXXXX did not testify and no documentary evidence was offered as to the number of for-profit non-members or how much revenue was earned by for-profit non-

members. No witness testified as to how it was possible for ABC to “discover” that it had for-profit customers without section 501(c)(3) exemption, in spite of the provisions in the Bylaws which prohibit laundry processing and sales to customers without section 501(c)(3) exemption. At the very least, it is clear that the provisions in the Bylaws covering service to non-members are not adhered to by ABC. Thus, ABC finds itself processing laundry and selling retail supplies to for-profit non-members, which is inconsistent with the Department’s 1972 letter exempting ABC, inconsistent with ABC’s Articles of Incorporation and inconsistent with their Bylaws. Unlike American Medical Colleges and unlike ABC in 1972, the functions that ABC performs for these for-profit non-members would not be exempt and would not qualify for exemption if performed by the for-profit non-members themselves.

Mr. XXXX also testified that he knew that some portion of ABC’s customers were for-profit institutions. He testified that it was “a very small percentage of our total,” “less than 3%.” Tr. p. 103. Mr. XXXX testified that less than 10% of ABC’s “client base” is composed of for-profit entities, but ABC’s relationships with the for-profits were “incidental” and “not the main focus” of ABC’s operations. Tr. pp. 156-157. No documentary evidence was offered to support any of this testimony. ABC’s financial statements contain totals for revenue from non-members, as discussed above, but there is no further breakdown of this revenue into for-profit and not-for-profit non-members. It is strongly noted that a “very small percentage” of customers does not necessarily indicate that a very small percentage of revenue is earned from these customers.

ABC’s Memorandum of Law argues that “[A]t the hearing on this matter before the ALJ, testimony confirmed that a very small number of ABC’s customers are non-exempt for-profit organizations.” (ABC Memo. p. 6). In fact, this statement does not

reflect the evidence at hearing because the testimony does not allow me to determine either the number of ABC' non-exempt, for-profit customers or the revenue that ABC earns from these customers. The testimony was that 40% of the 10% clinic route is for-profit (XXXX), or less than 3% of customers are for-profit (XXXX), or under 10% of the "client base" is for-profit (XXXXX). No witness testified as to the number of ABC' customers in the clinic route, or the total number of ABC' customers, or the total number of customers in the "client base." Ms. XXXX did testify that ABC had 400 off-site locations. Tr. p. 82. Assuming, because no testimony or evidence was offered on this point, that for-profit customers are off-site locations, then the number of ABC' for-profit customers could be under 40 (under 10% of 400 according to XXXX) or 12 (3% of 400, according to XXXX). Because I cannot determine if ABC' for-profit customers were 12 or 40, and because there was no testimony as to the revenue earned from these 12 or 40 for-profit customers, I cannot conclude that the number of for-profit customers is "incidental" or "not the main focus" of ABC' operations as XXXX suggests. Certainly, no documentary evidence was offered to support any of these figures.

The issue to be tried at the evidentiary hearing was whether ABC was a tax-exempt organization in accordance with Illinois statutes and regulations. Selling a service to for-profit businesses is not recognized as a charitable purpose in Illinois. Rather, it indicates that ABC is conducting business in a manner inconsistent with a charitable organization and operating outside of its Bylaws. ABC argues in its Memorandum that it "has not materially changed its operations since it was first issued its sales tax exemption in 1972..." (ABC Memo. p. 3). In reality, ABC' service to non-members and for-profit non-members is evidence that ABC' activities have materially and significantly changed since the issuance of the 1972 letter which contemplated that

ABC would provide laundry service for “member charitable institutions” only, and indicates again that the considerations which fostered ABC’ exemption in 1972 are no longer valid. ABC’ status as a charitable institution was derived from the charitable status of its members, not from serving unknown non-members, some of whom are for-profit. ABC’ laundry processing for for-profit entities is outside the scope of its Bylaws and these facts raise serious doubt as to whether the other provisions in the Bylaws for non-member customers are being followed.

In its Memorandum, ABC argues that “[A]lthough the facts of this case may appear complex, at bottom, its outcome may depend upon whether ABC’ provision of a very small percentage of its services to non-exempt organizations so changes ABC’ purpose as to justify the revocation of its charitable status...” (ABC Memo. p. 2). The record in this case does not prove that ABC provides a “very small percentage of its services to non-exempt organizations.” As discussed previously, no documentary evidence was offered by ABC as to the number of its for-profit customers or the revenue earned from for-profit customers. The oral testimony that guesstimated that 10% of ABC’ business is the “clinic route” and 40% of that group may be for-profit, or that for-profit business is a very small percentage, less than 3%, or that under 10% of ABC’ client base is for-profit, does not provide a reliable basis for me to determine either the number of for-profit customers or the revenue earned from them.

ABC recognized that this case “may depend” on its service to non-exempt organizations. The fact that the record is so lacking in information on this very issue forces me to conclude either that ABC does not know what the revenue from their for-profit business actually is or that ABC made a strategic decision to keep the information about its revenue from for-profit business out of the evidentiary hearing. Either of these

scenarios indicates that the Department's concerns about ABC' operations and consequent revocation of ABC' tax exemption were warranted. If ABC' revenue from for-profits is "incidental," documentary evidence should have been offered to support this. It was incumbent on ABC to present documentary evidence as to the exact number of for-profit customers and revenue earned from these for-profit customers. The absence of this documentary evidence provides support for affirming the Department's revocation of ABC' sales tax exemption.

**Termination of Laundry Service:** According to the testimony at the hearing, any "customer" that wants ABC to provide them with laundry and linen service must sign a "Customer and ABC Services Laundry-Linen Service: 3 Year Agreement."<sup>1</sup> Paragraph 21 of this Agreement, entitled "Tax Exempt Status," states that "Customer shall, during the period covered by this Agreement, maintain its status as a hospital or other organization exempt from federal income tax under 501C(3) of the Internal Revenue Code of 1986 and its successor sections, and exempt from federal and state income and sales, use, retailers' occupation, service use and real estate taxes. Upon the loss of any such exemption, customer shall immediately notify ABC." Paragraph 27 requires that the Agreement "shall in all respects be governed by, and construed in accordance with, the laws of the State of Illinois." Tr. pp. 71-73; Taxpayer's Ex. No. 1.

Ms. XXXX testified that if a customer becomes a for-profit corporation after signing the agreement, "we would tell them that we're going to have to terminate their agreement and that they would have to find a different service." Tr. p. 79. According to her testimony, XXXX Memorial Hospital, an original member of ABC, lost its not-for-

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<sup>1</sup> The Department Auditor's "Audit Narrative" for ABC states that "[M]ost of all the laundry services are done through a 3-5 year rental agreement with the customer." Dept. Ex. No. 3. There was no testimony at the hearing about a 5 year laundry agreement.

profit status when it became affiliated with Vanguard, “which is a for-profit entity.” XXXX was forced to leave ABC’ Board of Directors and “leave the ownership interest of ABC.” “They were no longer considered an owner or a customer.” Tr. pp. 58-59.

Apparently XXXX Memorial Hospital is the only member/owner that went from not-for-profit to for-profit status. Both Ms. XXXX and Mr. XXXX testified that all of ABC’ members/owners are not-for-profit corporations and section 501(c)(3) organizations. Tr. pp. 57-58, 125-126. However, no documentary evidence was admitted to support this. Mr. XXXXX testified regarding certain non-member customers that used ABC for laundry service and who went from not-for-profit to for-profit status. XXXX Hospital and XXXX Clinics, customers but non-members of ABC, changed ownership, becoming part of Sisters of XXXX, “recognized as a for-profit joint venture.” “And we declined to continue service for them after they made that change.” According to his testimony, in 2005 and 2006, XXXXX Memorial Hospital and XXXX associated service centers, non-members and customers of ABC, were purchased by XXXX Health Services, “which was for profit.” “And they had to send their business elsewhere. We terminated their agreement.” Tr. pp. 94-95.

There are several troubling issues with regard to ABC’ termination of services for non-member customers. First, Paragraph 21 of the laundry service agreement requires the customer to “immediately” notify ABC upon the loss of exempt status. Taxpayer’s Ex. No. 21. There was no testimony at the hearing as to what is meant by “immediately” as the word is used in the laundry service agreement. The laundry service agreement does not define the term “immediately.” There was no testimony that ABC does any independent checking of the status of its customers during the term of the agreement. There was no testimony that ABC has any internal controls in effect to ascertain that its



customers maintain tax exempt status over the course of the Agreement. The laundry service agreements are three-year agreements and it is not unreasonable to conclude that a non-member customer could take months before “immediately” notifying ABC that it had lost its exempt status. During the period of time between loss of exempt status and notification, ABC is providing “charitable” laundry service to for-profit entities. Additionally, it is unclear from the testimony whether these for-profit entities that have changed status are part of the less than 10%, or 40% of the 10% clinic route, or a very small percentage, less than 3%, discussed previously, that ABC guesstimates as their for-profit business, but, for which, no documentary evidence was admitted.

Further compounding this problem is Mr. XXXXX’s testimony that termination of services to a customer that has lost exempt status “can take anywhere from a month to three months.” Tr. p. 95. Ms. XXXX testified that upon a change in customer status, “you wouldn’t want to just leave the hospital high and dry, but you would have to tell them within a reasonable amount of time that they would have to find their services elsewhere.” Tr. p. 80. At any time during the year then, ABC can be providing its “charitable” laundry services to for-profit non-members that have failed to “immediately” notify ABC that their status has changed. ABC can also be providing its “charitable” laundry services to for-profit non-members that have notified ABC that their status has changed, but who are still being serviced by ABC in order to not leave them “high and dry.” It is unclear from the testimony whether these for-profit non-members that ABC will not leave “high and dry” are part of the less than 10%, or 40% of the 10% clinic route, or a very small percentage, less than 3%, that ABC guesstimates as their for-profit business but, for which, no documentary evidence was admitted. It must be noted again that providing “charitable” services to for-profit businesses is inconsistent with the

activities of a charitable institution, not contemplated as part of ABC' "sole purpose" in the Department's 1972 letter exempting ABC, inconsistent with ABC' Articles of Incorporation and not sanctioned under ABC' Bylaws.

**Retail Sales to For-Profit Non-Members:** In January, 2006, the Department conducted an audit of ABC. The "Audit Narrative" dated November 28, 2006, states that "[ABC] also sells recyclable bags which are used to transport their customer's laundry. These bags are sold to their customer[s], ABC picks up the soiled linen in the bags and transports them to their headquarters in Wheeling. The bags are then disposed of after the linens are emptied." "The only tangible personal property the taxpayer sells are the recyclable bags." The Department's auditor assessed retailers' occupation tax on approximately \$19,000 in recyclable bags sold to 10 taxable customers for the audit period. Tr. pp. 38-51, 104-105, 113-114, 159-162, 186-191; Dept. Ex. Nos. 3 and 4. On October 2, 2006, the Department issued an EDA-123, "Notice of Proposed Assessment," to ABC for sales tax due on the recyclable bags in the amount of \$1,662 plus penalty and interest. Tr. pp. 162-164; Taxpayer's Ex. No. 4.

Mr. XXXX testified that ABC' total bag sales are approximately \$500,000/year and total bag sales over the 5-year audit period were \$2,500,000. According to Mr. XXXX, the "very basis" for which the Department "pulled the exemption" was ten for-profit customers, with total sales in the audit period of \$19,000. "So it's far less than one fraction of 1 percent of the revenue from the bags [that] has been identified in this audit as the offending sales to for-profits...." Tr. pp. 109-111. Mr. Novak also testified that revenue from bag sales during the audit period was "roughly two-and-a-half million dollars" and that sales to the ten for-profit customers amounted to \$19,000, "less than one percent." Tr. pp. 164-165.

No documentary evidence was admitted to support the \$2,500,000 for bag sales over the 5 year period of the audit. ABC' financial statements show "Rag and recyclable bag sales" as one component of "total revenues" and there is no further breakdown of recyclable bag sales by itself. It is unclear from the testimony whether these for-profit non-members that purchase recyclable bags from ABC are part of the less than 10%, or 40% of the 10% clinic route, or a very small percentage, less than 3%, that ABC estimates as their for-profit business but, for which, no documentary evidence was admitted.

Counsel for ABC argued at the hearing that ABC is not "doing business outside [its] scope by [selling] bags. We're not in the bag business." Tr. p. 170. It is unclear what "scope" counsel was referring to. The issue is not whether ABC is in the "bag business." The issue is that selling tangible personal property to for-profit entities, in addition to the other practices discussed above, is inconsistent with the activities of a charitable institution, not contemplated by the Department's 1972 letter exempting ABC, inconsistent with ABC' Articles of Incorporation and not sanctioned by ABC' Bylaws.

**Laundry Processing for For-Profit Non-Members:** ABC' attempts at the evidentiary hearing to minimize the sale of recyclable bags as "less than one percent," is misleading. In addition to selling the recyclable bags to the ten for-profit non-members, the bags are returned to ABC by these for-profit non-members with laundry to be processed by ABC.<sup>2</sup> Tr. pp. 170-171. Mr. XXXX testified that he went through the records of ABC and examined the "poundage of wash we did for them in the year 2006." Mr. XXXXX testified that ABC processed 738,603 pounds of laundry for the ten for-

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<sup>2</sup> Mr. XXXXX testified that the Department's audit did not look at the 10 for-profit customers' poundage of processed laundry. "The audit only looked at bags." Tr. pp. 171-172. The audit report does not mention poundage of processed laundry. Dept. Ex. Nos. 3 and 4.

profit non-members in 2006 and that this represented 1.32% of ABC' total poundage for the year. Tr. pp. 173-174. Counsel for ABC asked Mr. XXXX this question: "So doing business in 2006 for people outside the scope of our organization, to the extent that we use those ten identified non-for-profits, represents 1.3% of the business of ABC?" Mr. XXXX responded "Correct." Tr. pp. 173-174.

No documentary evidence was offered to support this testimony. The 738,603 pounds of laundry that ABC admits it processed for for-profit non-members is 1.32% of 55,954,772 pounds. This number corresponds with Mr. XXXX's testimony that ABC processed approximately 56 million pounds of laundry in total for 2006. Tr. p. 171. The financial statements show that the average laundry processing charge in 2006 was .5161 cents/pound. Assuming that ABC processed 738,603 pounds of laundry at .5161 cents/pound for the for-profit non-members, this would have generated revenue for ABC of \$381,193, in addition to the \$19,000 of recyclable bags sold to these for-profit non-members.

Mr. XXXX was asked whether "[t]here are any companies that [ABC] does business with that are outside [ABC'] organizational bylaws?" He responded: "Not to my knowledge." Tr. p. 168. However, neither Mr. XXXXX, nor other ABC' witnesses, pointed out the provision in ABC' Bylaws that allowed ABC to make retail sales to and process laundry for these for-profit non-members. It is unclear from the testimony whether the for-profit non-members that are in the less than 10%, or 40% of the 10% clinic route, or a very small percentage, less than 3%, are the same for-profit non-members that have "immediately" notified ABC of a change in exempt status and are not being left "high and dry," or if either of these groups of for-profit non-members are part

of the 10 for-profit non-members that are sold recyclable bags by ABC and who return the bags to ABC with 738,603 [undocumented] pounds of laundry to be processed.

In Association of American Medical Colleges v. Lorenz, 17 Ill. 2d 125, 129 (1969), discussed previously, the Court stated that “[W]here the functions themselves qualify for exemption it does not matter that they are performed by a separate organization rather than by the respective member institutions.” Processing laundry for for-profit businesses is not a “function” that would be exempt if performed by the for-profit business. Processing \$381,193 in laundry for for-profit non-members and selling these for-profit non-members \$19,000 in supplies, in addition to the other practices discussed above, is inconsistent with the activities of a charitable institution, not contemplated by the Department’s 1972 letter exempting ABC, inconsistent with ABC’s Articles of Incorporation and not sanctioned by ABC’s Bylaws. It must be strongly noted, however, that the figure of \$381,193 in laundry processing charges for for-profit non-members is my own estimate based on the testimony at the hearing and the financial statements. No documentary evidence was offered by ABC with regard to how many of its non-member customers were for-profit businesses, the total revenue received from for-profit non-members, the revenue received from processing laundry for for-profit non-members, the revenue from retail sales to for-profit non-members, or the laundry poundage processed for for-profit non-members.

ABC notes in its Memorandum that in Decatur Sports Found. v. Dep’t of Revenue, 177 Ill. App. 3d 696 (4<sup>th</sup> Dist. 1988), where a sports complex was used six percent of the time by a non-exempt organization, the court found such use “incidental.” “Similarly, where a not-for-profit arts center retained twenty percent of any money it received for the sale of artists’ paintings from its gallery, the court found the art center

was nevertheless entitled to an exemption.” Resurrection Luth. Church v. Dep’t of Revenue, 212 Ill. App. 3d 964 (1<sup>st</sup> Dist. 1991). ABC argues in its Memorandum that “[E]vidence at the hearing showed that ABC’ primary purpose was to provide services to its charitable customers, and that its relationships with non-exempt entities are incidental or secondary to such purpose.” (ABC Memo. p. 17).

ABC’ comparisons to Decatur and Resurrection are without merit. Without documentary evidence, I am not able to determine ABC’ “primary purpose” and I not able to conclude that ABC’ revenue from for-profit non-members is six percent or twenty percent or that it is “incidental.” To the contrary, the only documentary evidence admitted on this point is the audited financial statements which show that in 2006 and 2005, revenue from non-members constituted 45% and 50%, respectively, of ABC’ “total revenues.” No documentary evidence was admitted to show that the non-members are recognized by the State of Illinois as charitable institutions exempt from sales tax. As a matter of fact, without any documentary evidence to prove otherwise, it is possible that all revenue from non-members is from for-profit businesses.

In exemption cases, the applicant bears the burden of proving “by clear and convincing” evidence that the exemption applies. Evangelical Hospitals Corp. v. Department of Revenue, 223 Ill. App. 3d 225, 231 (2d Dist.1991). Statements of the agents of an institution and the wording of its governing legal documents showing an intention to organize and operate for exclusively charitable purposes do not relieve the institution of the burden of proving that it is so organized and operated. Morton Temple Ass’n v. Dept. of Revenue, 158 Ill. App. 3d 794 (3d Dist. 1987). The Department’s revocation of ABC’ tax exemption is presumed to be correct, and ABC has the burden of clearly and conclusively proving that it is entitled to the exemption. Wyndemere

Retirement Community v. Department of Revenue, 274 Ill. App. 3d 455 (2<sup>nd</sup> Dist. 1995).

To prove its case, a taxpayer must present more than its testimony denying the Department's determination. The taxpayer must present sufficient documentary evidence to support its claim. Sprague v. Johnson, 195 Ill. App. 3d 798 (4<sup>th</sup> Dist. 1990). Moreover, it is well established that there is a presumption against exemption and that therefore, "exemptions are to be strictly construed" with any doubts concerning the applicability of the exemptions "resolved in favor of taxation." Van's Material Co. Inc. v. Department of Revenue, 131 Ill. 2d 196 (1989).

In light of ABC' recognition that this case "may depend" on its service to non-exempt non-members, the absence of documentary evidence in the record on that very issue is fatal to its claim for exempt status. The absence of documentary evidence on this issue forces me to conclude that ABC either does not know what its business with for-profit non-members actually is, or that ABC made a strategic decision to offer only oral testimony on the issue. The serious concerns raised by either of these approaches must be resolved in favor of affirming the Department's revocation of ABC' sales tax exemption.

**THE ORGANIZATION DOES NOT PROVIDE GAIN OR PROFIT IN A PRIVATE SENSE TO ANY PERSON CONNECTED WITH IT:**

**Wages, Salaries, Fringe Benefits, Crothall Services Group:** ABC' financial statements show that "Wages, salaries and fringe benefits" were \$15,081 M in 2006 and \$19,264 M in 2005. There was no testimony or documentary evidence admitted at the hearing about wages or salaries. No witness who testified for ABC was asked what their salary was. There was no testimony or documentary evidence offered about "fringe benefits." There was no testimony or documentary evidence as to whether ABC pays a

bonus to its employees. 86 Ill. Adm. Code § 130.2005, entitled “Persons Engaged in Nonprofit Service Enterprises,” states that an organization cannot qualify as being organized and operated exclusively for charitable purposes unless no personal profit inures to anyone as a result of the organization’s operations. “The payment of reasonable salaries to necessary employees for services actually rendered does not convert a nonprofit enterprise into a business enterprise.” 86 Ill. Adm. Code § 130.2005(h). There was no testimony as to whether ABC’ wages, salaries, and fringe benefits were “reasonable” or how any of these costs compared to those of similar institutions.

Ms. XXXX and Mr. XXXX testified that they were employed by XXXXX Services Group, “which has a management agreement to manage ABC Services.” Tr. p. 53. Mr. XXXX testified that “XXXX is a management services group that basically provides services for facilities like ABC to oversee the management and ongoing operation of their sites.” Tr. p. 87. There was no testimony or documentary evidence as to how much XXXX is paid for this service. XXXX is not mentioned in ABC’ financial statements or notes to the financial statements. Because the record in this case contains no information on ABC’ wages, salaries, fringe benefits and payments to XXXXXI Services Group, I am unable to conclude that ABC does not provide gain or profit in a private sense to persons connected with it.

**Patronage Dividends:** ABC’ Bylaws, Article XVI, entitled “Patronage Dividends,” state that if ABC realizes taxable income in any fiscal year, such taxable income shall be distributed to the members and non-members of the corporation within 8½ months after the close of the fiscal year on the basis of the quantity of business done between each member or non-member and the corporation during the fiscal year. Taxpayer’s Ex. No. 2. “Note 1” to ABC’ financial statements states that because ABC is



a nonexempt cooperative, its taxable income can be offset by patronage dividends. “In accordance with the Company’s bylaws, patronage dividends are to be declared for members to the extent of taxable income in any fiscal year.” “No dividends were declared in 2006 and 2005 since the Company has net operating loss carryforwards.” Dept. Ex. No. 5.

According to ABC, the payment of patronage dividends “is based on the exigencies created by federal tax law.” The United States Supreme Court has held that hospital laundries are not exempt under Section 501 of the Internal Revenue Code. HCSC Laundry v. U.S., 450 U.S. 1 (1981). However, the IRS has allowed hospital laundries to avail themselves of the benefits in the Code governing cooperatives, which allow cooperatives to eliminate otherwise taxable income by distributing any such income as a patronage dividend. (See 26 U.S.C. § 1381-1388 [“Subchapter T”] and Rev. Ruling 69-633). (ABC Reply, p. 6). Under the provisions of “Subchapter T,” nonexempt cooperatives may apply previous years’ losses against current years’ gains. When patronage dividends are paid, they are excluded from the cooperative’s taxable income. 26 U.S.C. § 1382(b). “Therefore, if and when ABC has no more losses to carry forward to offset against its net income for any given year, it may use the procedures sanctioned by the IRS under Subchapter T to reduce such otherwise taxable income to zero by distributing patronage dividends to its charitable customers.” (ABC Reply, p. 7).

ABC argues that “[T]his is not, as the Department suggests, a violation of Methodist Old People’s Home’s prohibition on the payment of ‘profit’ to ‘shareholders,’ but rather, a well-established and legitimate way for ABC to redistribute its patron’s funds back to them according to their respective levels of contribution.” (ABC Reply, p. 7). The IRS provisions under Subchapter T may be a “well-established and legitimate

way” for ABC to repay its “patrons,” but the provisions are not decisive for determining whether ABC is entitled to a sales tax exemption under Illinois statutes.<sup>3</sup> Moreover, the provision in ABC’ Bylaws for the payment of patronage dividends becomes problematic when one considers who ABC’ “patrons” are.

ABC argues that when the time comes that it has no losses to carry forward to offset against taxable income, it may reduce its taxable income to zero “by distributing patronage dividends to its charitable customers,” and by redistributing “its patron’s funds back to them according to their respective levels of contribution.” ABC Reply, p. 7. As discussed previously in this Recommendation, the record in this case contains no evidence that ABC’ non-members are “charitable customers.” Some of these non-members customers are for-profit businesses. ABC’ argument that it is redistributing its “patron’s funds” according to their respective level of contributions is without merit. The non-members are not making a “contribution” to ABC when ABC processes their laundry or sells them recyclable bags. The non-members are doing business with ABC. They are buying services and/or products from ABC in arms-length transactions.

The provision in ABC’ Bylaws for the payment of patronage dividends allows ABC to distribute its income to members and nonmembers “on the basis of the quantity of business done between each member and non-member and the corporation during the fiscal year.” Taxpayer’s Ex. No. 2. In fact, Mr. Novak testified that it was “his understanding” “that the patronage dividend would be paid to anyone that we provided a service to.” Tr. p. 193. ABC is allowed then, according to its Bylaws, to distribute a dividend to non-members, including for-profit non-members, based on the quantity of

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<sup>3</sup> See, for example, Decatur Sports Found. v. Dep’t of Revenue, 177 Ill. App. 3d 696 (4<sup>th</sup> Dist. 1988), where the court held that exemption from federal income tax is not determinative of whether property is used for charitable purposes.

business these entities did with ABC in the fiscal year. This provision in ABC' Bylaws forces me to conclude that ABC provides gain and profit in a private sense to persons connected with it, which is proscribed by Korzen, inconsistent with the operations of a "charitable" organization, and characteristic of a for-profit commercial enterprise.

**ADVERTISING:** It is clear from the Department's 1972 letter exempting ABC and ABC' Articles of Incorporation and Bylaws, that ABC was not incorporated to provide "charitable" laundry service and make retail sales to all who needed and applied for them. ABC' sales tax exemption depended on ABC having a limited customer base. The Department's 1972 letter limited ABC' customers to "member charitable institutions." ABC' Articles of Incorporation limited ABC' customers to "member hospitals and health care institutions." ABC' Bylaws limited ABC' customers to members and non-members that are exempt under section 501(c)(3). In spite of these limitations, evidence at the hearing showed that ABC was offering its services to all paying customers, providing further justification for affirming the Department's revocation of ABC' sales tax exemption.

Ms. XXXX testified that ABC does "very little in the way of marketing our services." "We mostly get our business through word of mouth, through hospital affiliations where a hospital will affiliate with one of our current customers." Tr. p. 66. Ms. XXXX was asked whether ABC markets to for-profit or not-for-profit entities. She replied: "Well, we market to not-for-profit entities." Tr. pp. 73-74. In contrast, Mr. XXXX testified that ABC did not market to for-profit entities. Tr. p. 157. Mr. XXXXX was asked if ABC markets to not-for-profit health care entities. He replied: "Presently ABC markets to its existing customer core for additional services that are available." Tr.

p. 92. Since ABC' "existing customer core" includes for-profit businesses, I must conclude from Mr. XXXXXr's response that ABC does market to for-profit businesses.

The Department caused to be admitted into evidence two of ABC' advertising brochures. Dept. Ex. Nos. 6 and 7. With regard to these brochures, Mr. XXXX testified as follows:

These are brochures that are used for the clinics. Our drivers are out in the neighborhood making deliveries, they're dropped off at the existing location, and/or if they see someone that's in the same vicinity as our delivery truck, they'll drop off [brochures] for their information.  
Tr. p. 180.

The first brochure is entitled "Textile Surgical Gowns, Q.D." Mr. XXXX testified, with regard to the services advertised in this brochure, that "we probably try to do a little bit more marketing on [this brochure] only because there are not any other facilities in the Chicagoland area that can provide the same type of service that we do for that type of product." Tr. p. 180. This brochure states that "Reusable gowns are half the cost of disposables-and with door-to-door service, making the switch couldn't be easier." "To learn more or request procedure packs with reusable textiles in your operating room contact: (Phone) and (Fax)" Dept. Ex. No. 6.

The second brochure states on its front cover that "Quality, Convenience and Savings Go a Long Way." The inside of the brochure advertises in large print "Chicagoland's Laundry and Linen Leader." "ABC, a company owned and operated by a group of Chicago area hospitals and nursing homes, has been the innovative leader in linen services to the healthcare community for the past thirty years. ABC offers high quality, hygienically clean linen items with a 100% satisfaction guarantee." This brochure lists 18 "Typical ABC Clinic Route Customers." Not one of these 18 "typical" clinic route customers is identified as a not-for-profit or 501(c)(3) corporation. This

brochure also contains the following: “Constantly striving for the latest and greatest ways to provide customers like you with superior quality, service and cost savings is a privilege that we value highly at ABC. When it comes to our Linen Services and Programs, we believe dedication and caring go a long way. Maybe that’s what has kept ABC in the lead, here in the Chicagoland Healthcare community, for the past thirty years.” Dept. Ex. No. 7.

Astoundingly, neither of the brochures mentions that ABC is owned by “hospitals and nursing homes” that are non-profit and section 501(c)(3) organizations or that ABC only processes laundry for and sells supplies to section 501(c)(3) companies, as is required by its Bylaws. Neither brochure mentions that ABC will provide free service to an organization that cannot afford to pay. Mr. Novak testified that ABC’ drivers leave these brochures with existing customers and if they see a potential customer in the same vicinity, they will leave a brochure with that entity. Tr. p. 180. There was no testimony that ABC’ drivers determine whether the potential customer has section 501(c)(3) designation before leaving a brochure. Any potential customer reading these brochures would know that ABC wants to provide customers “like you” with “superior quality, service and cost savings” and that ABC is “in the lead, here in the Chicagoland Healthcare community, for the past thirty years.” What the potential customer would not know from the advertising is that ABC can only provide this quality, service and cost savings to section 501(c)(3) companies, in accordance with its Bylaws. If “cost savings” equates with the “charitable” processing of laundry and sale of supplies, ABC is advertising its “charitable” services and sales to institutions that may not be charitable, may not need charitable services, may not be section 501(c)(3) organizations and that may be for-profit entities. These brochures show that ABC is aggressively seeking all

customers and aiming to maximize its customer base, just like any for-profit commercial enterprise. Competing for customers with advertising brochures that do not mention either that ABC is a “charitable” organization or that it serves only “charitable” customers is inconsistent with the operations of a “charitable” organization.

The testimony by ABC’ witnesses that ABC does not market to for-profit companies is not believable in light of the advertising brochures that contain no indication that ABC’ customer base is limited by its Bylaws. The advertising brochures seem designed to appeal to for-profit companies where “superior quality, service” and, most importantly, “cost savings” can increase net income. Ms. XXXX testified that ABC “discovered” that some of its’ customers may not have section 501(c)(3) designation. Tr. pp. 64-65. This “discovery” is not surprising in light of the advertising brochures which do not advise potential customers that they must have section 501(c)(3) designation.

The content and method of distribution of ABC’ brochures force me to conclude that ABC is actively competing for customers with for-profit laundry services, which are engaged in providing the same laundry service and selling the same supplies as ABC, but without the benefit of the sales tax exemption, previously enjoyed by ABC. The content and method of distribution of ABC’ brochures force me to conclude that ABC is advertising its services to all potential customers and that ABC will process laundry and sell supplies to any customer who asks, in contravention of the Department’s 1972 letter exempting ABC, ABC’ Articles of Incorporation and ABC’ Bylaws, and providing further reason for affirming the Department’s revocation of ABC’ sales tax exemption.

In exemption cases, the applicant bears the burden of proving “by clear and convincing” evidence that the exemption applies. Evangelical Hospitals Corp. v.

Department of Revenue, 223 Ill. App. 3d 225, 231 (2d Dist.1991). The overwhelming absence of documentary evidence in this case, on issues that ABC recognizes as pivotal in determining whether they are entitled to an exemption from sales tax as a charitable institution, forces me to conclude that ABC has not proven, by clear and convincing evidence, that the exemption applies.

For the above stated reasons, I recommend that the Department's revocation of ABC' sales tax identification number be affirmed

ENTER:

Kenneth J. Galvin

November 5, 2007